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88-1109

No.

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1988

CBC, INC., a corporation,

PETITIONER,

v.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,

RESPONDENT.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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63 pp

I

QUESTIONS PRESENTED FOR REVIEW

1. Can "reports" under oath be massaged by the Board of Governors of the Federal Reserve System [Board] by rule-making into an "audit certified by an independent public accountant" not only of the one-bank holding company [BHC] but also of its only state nonmember bank owned by 3 people contrary to the unambiguous provisions of 12 U.S.C. §1844(c) which only permit "reports" by the BHC and stating that the Board itself "may make examinations" but "shall as far as possible use" the reports of the Federal Deposit Insurance Corporation or of the bank's State supervisory authority?

2. Can the Tenth Circuit overrule the decision of this Court in Board of Governors of the Federal Reserve System v. Dimension Financial Corporation, 474 U.S. 361, 106 S.Ct. 681, 88 L.Ed.2d 691 (1986), affirming Dimension Corporation v. Board

of Governors of the Federal Reserve System, 744 F.2d 1402 (Cir. 10, 1984), in holding that the Bank Holding Company Act [BHCA], 12 U.S.C. §1841 et seq., does not have a "public good" or "public benefit" provision, as the statute's purpose was to protect against possible abuses related to monopolistic practices, lessening of competition and extension of credit to finance an unrelated business concern over which the BHC has control?

3. Can the Board become the guru of a State nonmember bank merely because that bank is owned by a one-bank holding company?

4. Can the Tenth Circuit's definition of "report" as being synonymous with the words "audit certified by an independent public accountant" be upheld when it is not supported by any case law and is contrary to the definition existing in Webster's Second New International

Dictionary (1944 Ed.) and (1961 Ed.) at the time of passage of the BHCA and 12 U.S.C. §1844(c) in 1956?

5. Can the Board's regulation be sustained where it has totally failed to meet the regulation's standard of review as to (1) Requiring a "report" "certified by an independent public accountant"; (2) Why such an audit and its exorbitant cost is thrust upon BHCs with consolidated assets of $150 million or more; (3) Why it is not possible to use the bank's regulators' reports of examination?

II

PARTIES

All parties are named in the caption. Petitioner, CBC, Inc., owns all of the stock of The Citizens Bank of Clovis, a New Mexico corporation, which latter has no subsidiaries or affiliates except CBC, Inc.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

The petitioner respectfully prays that a writ of certiorari issue to review the opinion of the United States Court of Appeals for the Tenth Circuit entered on August 30, 1988, and concerning which petitioner's Petition For Rehearing And

For Rehearing En Banc was denied on October 25, 1988.

OFFICIAL AND UNOFFICIAL REPORTS BELOW

None published on date of this petition.

GROUNDS FOR JURISDICTION

The jurisdiction of this Court to review the judgment of the Tenth Circuit is invoked under 28 U.S.C. §1254(1) and 5 U.S.C. §702.

STATUTES AND REGULATIONS INVOLVED

The Bank Holding Company Act [BHCA], 12 U.S.C. §1844(c) provides:

> "The Board from time to time may require reports under oath to keep it informed as to whether the provisions of this Act and such regulations and orders issued thereunder have been complied with; and the Board may make examinations of each bank holding company and each subsidiary thereof, the cost of which shall be assessed against, and paid by, such holding company.

> The Board shall, as far as possible, use the reports of examinations made by the Comptroller of the Currency, the Federal Deposit Insurance Corporation, or the appropriate State bank supervisory authority for the purposes of this section."

The regulations issued pursuant to 12 U.S.C. §1844(c) appear in 12 C.F.R. §225.5(b) and (c) as follows:

> "(b) Reports of Bank holding companies. Each bank holding company shall furnish, in the manner and form prescribed by the Board, an annual report of the company's operations for the fiscal year in which it becomes a bank holding company, and for each fiscal year during which it remains a bank holding company. Additional information and reports shall be furnished as the Board may require.
>
> (c) Examinations and inspections. The Board may examine or inspect any bank holding company and each of its subsidiaries and prepare a report of their operations and

> activities. With respect to a foreign banking organization, the Board may also examine any branch or agency of a foreign bank in any state of the United States and may examine or inspect each of the organization's subsidiaries in the United States and prepare reports of their operations and activities. The Board will rely as far as possible on the reports of examination made by the primary federal or state supervisor of the subsidiary bank of a bank holding company or of the branch or agency of the foreign bank."

STATEMENT OF THE CASE

This appeal is by CBC, Inc., [CBC], a one-bank holding company, from Docket R-0548, a final rulemaking by the respondent, Board of Governors of the Federal Reserve System [Board], amending Regulation Y [Reg. Y], 12 C.F.R. Part 225, which implements the Bank Holding Company Act [BHCA], 12 U.S.C. §§1841-1850. CBC's

objection is to the requirement that bank holding companies with total consolidated assets of $150 million or more shall file consolidated financial statements certified by an independent public accountant with a form designated FR Y-6 titled Annual Report of Bank Holding Companies. A consolidated asset audit would require the bank to be audited in addition to the holding company and its nonbank subsidiaries.

The Bank Holding Company Act Amendments of 1970 brought one-bank holding companies into the BHCA for the first time. The Board vacillated on requiring independent audits. In 1975 no such audits were required at all. Then the Board out of thin air seized on a cutoff figure of $100 million of total banking assets saying with tongue in cheek that the cost of external audits is burdensome in some instances and small BHCs could be exempted. The former FR Y-6 form did

provide for such an exemption where the external audit constituted an "undue burden or expense". CBC on February 28, 1983, applied for an exemption which was denied by the Dallas Federal Reserve. An appeal to the Board under 12 C.F.R. §265.3 for review was pending and became moot when the Board's Docket R-0548 was noticed. A response to CBC's Freedom of Information Act [FOIA] inquiry revealed that the Board had never granted an exemption for the external audit based on "undue burden and expense". Such words no longer appear in the current rule.

Docket R-0548 is the first time that the Board has permitted the independent public audit requirement to become subject to public comment under the Board's rule-making power. CBC did file its comment, lengthy and detailed, which is part of the record. It is likely that CBC's appeal triggered the Board's use of its

rulemaking power in Docket R-0548. In any event, the Board has totally failed to articulate reasons demonstrating reliance on all relevant factors necessitating such an external audit for BHCs having consolidated assets of $150 million. The statute creating the BHCA does not endow the Board with the power to examine the bank in the first instance absent the impossibility of using the reports of examination of the bank's primary regulators.

CBC, petitioner, is a closely held, 3 stockholders, one-bank holding company. Two of the stockholders are brothers owning 4,980 shares of the 5,000 issued shares, and the third stockholder owning a director's qualifying twenty (20) shares is president of the holding company and the bank. CBC owns all of the stock of The Citizens Bank of Clovis [bank] which alone has some $154 million in assets. The three (3) stockholders are the sole

directors of CBC and of the bank. CBC owns and operates only the bank.

The bank is a nonmember New Mexico state bank chartered in 1916. The brothers have been directors and actively engaged in management of the bank since 1960. Prior thereto, the brothers' father was president of the bank from 1940 to 1967. The bank is examined by the Federal Deposit Insurance Corporation and the Director of Financial Institutions of the State of New Mexico. The cost of a certified independent audit of the bank is estimated at $75,000 per annum. The bank pays its primary regulators for their examinations and regulations, $17,852.50 to the State in 1987 and $109,504.55 to the F.D.I.C. in 1988.

One reason given by the Board in its Proposal for a certified independent audit requirement is that it "is essential for supervisory purposes". The Board's

Supporting Statement for the Bank Financial Supplement, etc. states that "the certification requirement encourages safe and sound operations by bank holding companies and should be retained; . . . ." Audit of the bank has no relation to the expansion of bank holding companies or divestment of their nonbanking interests. There is not one reason articulated concerning why the $150 million consolidated assets is a cutoff point in the first instance nor of any reliance on relevant factors necessitating such an audit or cutoff point. The Board's statistical gathering simply doesn't require an audit of a bank when the Board has access to the primary regulators' examinations. The Board's relation to a closely held one-bank holding company is not analogous in any respect to that of the Securities Exchange Commission with respect to investors where under 15 U.S.C. §781(g)B.,

a minimum of 500 persons is required before registration with the S.E.C. is necessary, together with a balance sheet which under 15 U.S.C. §772.2(25) has to be certified by an independent public or certified accountant.

The Board assumes that certified independent audits are accurate and presumably cost effective. There is no Board definition as to what kind of an audit should be made, i.e., whether a compilation, a review, an opinion, or a guarantee. In fact the certified independent auditing is now under congressional investigation by Congressman John D. Dingell chairing an Oversight and Investigation of the Energy & Commerce Committee. A bank audit is a judgment call for which auditors are just not qualified to make. This is shown further by the Federal Response to Criminal Misconduct and Insider Abuse in the Nation's

Financial Institutions, House Report 98-1137, p.7, and the House investigation titled Penn Square Bank Failure Hearings 97-92 and 97-93. There should be no mystery about independent bank auditors' failures when one reads American Institute of Certified Public Accountants' "Audits of Banks" and the five (5) pages in Chapter 7 on "Loans", which represent every bank's largest asset, that tell an auditor almost nothing about valuing a bank's note case. The Board cannot make a factual base upon which to predicate an independent bank audit without the requirement falling into the pit of lack of substantial evidence resulting in arbitrary and capricious action. In fact, the Federal Deposit Insurance Corporation, the bank's principal regulator, has declared that its rating system used by its examiners under the Uniform Financial Institutions Rating

System is "the most reliable method for rating banks available anywhere".

The encapsulation of the above facts can lead one only to conclude that the Board's requirement of an external independent audit of bank holding companies with total consolidated assets of $150 million is not reasonable under its rule-making powers.

THE REASONS FOR GRANTING THE WRIT

I

> The decision of the Tenth Circuit is contrary to the holding of this Court in Board of Governors of the Federal Reserve System, 474 U.S. 361, 106 S.Ct. 681, 88 L.Ed.2d 691 (1986) affirming the Tenth Circuit in Dimension Financial Corporation v. Board of Governors of the Federal Reserve System, 744 F.2d 1402 (Cir. 10, 1984).

The opinion of the Tenth Circuit is a disgusting example of a court rewriting the respondent's, i.e., Board's, brief to

arrive at a desired result contrary to that Circuit's precedent and to avoid this Court's clear holding which affirmed 8 to 0 that Circuit's precedent. Appendix I. Apparently, the Tenth Circuit had a hard time with this simple case. It was argued January 12, 1988, and an opinion written by Judge Tacha, concurred in by Judges McKay and Barrett, was filed August 30, 1988, almost eight months later. The Petition For Rehearing And For Rehearing En Banc was filed September 29, 1988, and was not denied until October 25, 1988, long in excess of the immediate denial customary in the Tenth Circuit. This leads one to ask what was so hard about it? The answer is that the Tenth Circuit was trying to avoid its own holding and that of this Court to the effect that there is no "public good" or "public benefit" provision in the BHCA. Without such phrases

the Tenth Circuit opinion collapses like a wet tent in a high wind. This Court held at 106 S.Ct. 689:

> "If the Bank Holding Company falls short of providing safeguards desirable or necessary to protect the public interest, that is a problem for Congress, and not the Board or the courts to address."

Petitioner contended and presented ample data to show that questionable bank audits certified by an independed public accountant are not effective or commensurate with the cost. In fact, neither the Federal Deposit Insurance Corporation, the Comptroller of the Currency nor the Board of Governors require any such audit of banks regulated by them. It is very arguable that those entities do not have the power to so require without statutory changes.

The Tenth Circuit held that the "plain purpose" of the BHCA was to protect against possible abuses related to monopolistic

practices, lessening of competition, and extension of credit to finance unrelated business concerns over which the BHC has no control. This Court said the same thing. Id. 106 S.Ct. 684. Despite this, the Tenth Circuit relied on 12 U.S.C. §1844(b), which says that the Board can "issue such regulations as may be necessary to enable it to administer and carry out the purposes of the Act." This Court knocked such perverted reasoning into a cocked hat when it said in Dimension Financial, 106 S.Ct. 681, 688:

> "The 'plain purpose' of legislation, however, is determined in the first instance with reference to the plain language of the statute itself. . . . Application of 'broad purposes' of legislation at the expense of specific provisions ignores the complexity of the problems Congress is called upon to address and the dynamics of legislative action. . . . Invocation of the 'plain purpose' of legislation

> at the expense of the terms of the statute itself takes no account of the processes of compromise and, in the end, prevents the effectuation of congressional intent." 106 S.Ct. 681, 688-9.

The "report" provision of 12 U.S.C. §1844(c) is a "specific provision" and is not affected by any other provision of the BHCA. To say the contrary is to indulge in judicial dishonesty, more especially is this so when it was said in the process of affirming a Tenth Circuit decision.

A simple reading of 12 U.S.C. §1844(c) can lead one only to the conclusion that the "report" was to be made by the BHC and under oath if required. No living human being has ever seen a certified audit by a public accountant made under oath.

The fact that the Board "may make examinations" surely negates that the Board may require an audit certified by

an independent public accountant. The phrase that the Board "may make examinations" would have been entirely unnecessary if Congress had the remotest idea that the Board could require an audit certified by an independent public accountant. The opinion of the Tenth Circuit leaks like a sieve. It does not measure up to Tenth Circuit quality because it lacks rationality. The fact is one cannot massage a "report" by a BHC into an "audit" certified by an independent public accountant regardless of the Tenth Circuit's apparent belief that such might be a desirable thing.

If the BHC regulator thinks that to carry out the very limited purposes of the BHCA it needs an audit, would it not be better for it to ask Congress to legislatively authorize it rather than as here by convoluted reasoning try to do by indirection what can't be done directly?

Dimension Financial, supra, says that is what should be done. Petitioner does not think the Board can get Congress to do any such thing. This is the reason why the Board wants to sneak in the side door.

Straight reasoning would indicate that there is more basis for the bank regulators to require an audit certified by an independent public accountant of banks than that of BHCs. That a bank is owned by a BHC does not and should not make the bank subject to regulation by the Board. Under New Mexico case law to receive and maintain a state bank charter, The Citizens Bank of Clovis under §58-1-70, NMSA 1978, has to insure its deposits with an agency of the United States, i.e., the F.D.I.C. So it makes no difference what the Board says, the bank is going to do what the F.D.I.C. and the New Mexico Director of Financial Institutions require. If the Board in its assumed

curiosity over the bank wants to regulate the bank, the Board cannot add another layer of regulation on top of the F.D.I.C. and the State regulator. True the Board can ask for and receive the facts of dealings between the bank, its subsidiaries, and the BHC and its subsidiaries. Beyond that it is none of the Board's business. It is not necessary to have a certified independent audit of the bank to do that.

What we have under the Board's outlandish theory is an intentional, deliberate, premediated overreaching into other agencies' bailiwick to the detriment of the bank and far beyond the limited purpose of the BHCA. The carefully manicured language of 12 U.S.C. §1844(c) was obviously made to prevent what the Board now contends it can do. This statute is utterly without ambiguity and requires no construction.

The Tenth Circuit's decision conflicts with this Court's Dimension Financial holding and its own holding in the same case. It is an important question of federal law that should be settled by this Court.

II

The Tenth Circuit's construction of 12 U.S.C. §1844(c) in finding that the word "report" by a BHC is synonymous with "audit certified by an independent public accountant" of both the bank and the BHC has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision, and such is an important question of federal law which has not been but should be settled by this Court.

The Board did not take the position that the Tenth Circuit used in its opinion The Board relied almost solely on the theory that since there had been an audit

requirement for years, it necessarily had to be right. It is well settled that an agency's construction of a statute is not entitled to deference where neither the statute nor the legislative history contains one word expressly permitting the administrative authority assumed. Clarke v. Securities Industry Association, _____ U.S. _____, 107 S.Ct. 750, 93 L.Ed.2d 757 (1987); Western Bancshares, Inc. v. Board of Governors of the Federal Reserve System, 480 F.2d 749 (Cir. 10, 1973).

The Tenth Circuit used as the cornerstone of its opinion a dictionary definition of the word "report" adopted after the passage of the BHCA in 1956. The Board made no such unfounded claim. It is unusual that the Tenth Circuit strays off on a target not asserted by counsel in order to arrive at a result pleasing to the court but not presented,

argued, or adopted by counsel. Certainly, in a case as important as this, the Tenth Circuit should have asked counsel to file supplemental briefs on the subject which is the accepted and usual course of judicial proceedings in such circumstances.

In its effort to aid its imagined "public good" or "public benefit", the Tenth Circuit used that in the 1981 Edition of Webster's Third New International Unabridged Dictionary which says that "report" is defined as "something that gives information" or a "formal account of the results of an investigation by a person or group authorized or delegated to make the investigation (an audit)". [Emphasis writer's]. This piece of definitional meat being thrown into the pot smelled to petitioner.

Investigation revealed that Webster's New International Dictionaries from 1944 till the latter part of 1961 did not

contain the words "an audit". That such meaning appeared for the first time in Webster's Third International Unabridged Dictionary published in the latter part of the year 1961. To attribute to the Congress a definition not in existence at the time of passage of 12 U.S.C. §1844(c) is just too much. It has long been settled that words take their meaning in a statute as their meaning was at the time of the statute's enactment. 82 C.J.S., Statutes, §329, p.638; 73 Am.Jur.2d, Statutes, §204, p.399. This has always been the law in all courts and this Court where in Platt v. The Union Pacific Railroad Company, 99 U.S. 48, 60, 98-101 S.Ct. 424, 428, 25 L.Ed. 424 (1879) [Meaning of the words "disposed of"] it was held that:

> "All will concede that in construing the Act of 1862 we are to look at the state of things then existing and, in the light then

> appearing, seek for the purposes and objects of Congress in using the language they did. And we are to give such construction to that language, if possible, as will carry out the congressional intentions. (Emphasis writer's).

In Westerlund v. Black Bear Mining Co., 203 F. 599, 605, 607 (Cir. 8, 1913), the court stated:

> "The legal presumption that the Legislature used, and intended to use, these words in this statute in their usual sense at the time the law was passed, unless it clearly appears that they intended to use it in a more restricted or different sense."

That language was adopted in Amos v. Prom, Inc., 117 F.Supp. 615, 624 (D.C. N.D. Ia., 1954).

One of the most recent cases from this Court putting the matter in perspective is United States v. Locke, 471 U.S. 84, 95, 105 S.Ct. 1785, 1793, 85 L.Ed.2d 64 (1985) [Meaning of words "prior to December 31"

filing re mining claims] where Justice Marshall stated:

> "But the fact that Congress might have acted with greater clarity or foresight does not give courts a carte blanche to redraft statutes in an effort to achieve that which Congress is perceived to have failed to do. 'There is a basic difference between filling a gap left by Congress' silence and rewriting rules that Congress has affirmatively and specifically enacted'. Mobil Oil Corp. v. Higginbotham, 436 U.S. 618, 625, 98 S.Ct. 2010, 2015, 56 L.Ed.2d 581 (1978). [Court's Emphasis].

The Tenth Circuit's conclusion that a "report" is synonymous with "an audit certified by an independent public accountant" has to be a new high in judicial blundering.

Petitioner has searched exhaustively and found no case that says a "report" is an "audit" and a fortiori that even a

"report" has to be "certified by an independent public accountant". The Tenth Circuit pyramids error upon error. That an "audit" is a different breed of cat appears from an early case in this Court applying a witness expense statute regarding clerks or other officers of the United States which required that "necessary expenses . . . shall be audited and paid". In Sanborn v. United States, 135 U.S. 271, 10 S.Ct. 812, 816, 34 L.Ed. 112 (1890), where it was said: "Those items are to be examined, looked over, and adjusted; in other words they must be audited. The auditing contemplated by section 850 must be done, primarily in the court in which the case is pending, and where it can be best determined what expenses have been necessarily incurred by the witness." This clearly means that an "audit" is a procedure far different from a "report".

It is done by a third party, not a clerk or marshal, and there by a judge.

The lower court is rewriting 12 U.S.C. §1844(c). The error of the decision affects a few thousand banks. It is no small thing. As will be shown in the brief on the merits, it is utterly uneconomic. Decisions of the lower courts so blatantly wrong merit granting certiorari. Other courts will use the definition of "reports" to mean an "audit" to everyone's detriment. It is an important question of federal law not passed on by this Court but which should be settled by it.

III

The Board has totally failed to meet the regulators standards of review which constitute an arbitrary and capricious overreaching of the limited powers of the Board under the Bank Holding Company Act, 12 U.S.C. §1841

> et seq., particularly as to (1) Requiring a "report" to be an audit; (2) Why the audit only applies to BHCs with consolidated assets over $150 million; (3) Why can't the Board use the bank regulators' reports of examination.

The Tenth Circuit did not mention the subject of this Point III although Petitioner briefed it at length. That circuit takes a soft view of administrative regulation by directing its inquiry toward finding a rational basis for agency action. Wyoming Hospital Association v. Harris, 727 F.2d 936 (Cir. 10, 1984) [Regulations under the Hill-Burton hospital construction program]; Springfield Television of Utah, Inc. v. F.C.C., 710 F.2d 620 (Cir. 10, 1983) [F.C.C. allocation of V.H.F. television assignments]. The regulators in almost all instances hide behind informal rulemaking to prevent an adversarial confrontation with the victims of the

regulations. They do this by making an indigenous finding that formal rulemaking is not necessary. That is wrong however much affection one has for administrative law. But this procedure is aggravated by the fact that the basis for regulation changes is universally not stated with any clarity in informal rulemaking. The rulemaking in the instant case is a pregnant example.

First, is a "report" an "audit certified by an independent public accountant"? Reasons given by the Board in its Proposal are that such an independent audit "is essential for supervisory purposes" and that audits "encourage safe and sound operations". Proposed Bank Holding Company Reporting Requirements, Docket No. R-0548, p.28031, par. [3], 50 Federal Register No. 131, 7/9/85, Supporting Statement for BHCs, p.19. That statement is a result - not a reason. Why is it

essential? Cannot the Board believe the BHC's "report" under oath? The Board must examine the relevant data and articulate a satisfactory explanation for its action, because agency action not based on substantial evidence should be considered arbitrary and capricious. Motor Vehicle Mfrs. Assoc. v. State Farm Mutual Automobile Ins. Co., 463 U.S. 29, 103 S.Ct. 2856, 77 L.Ed.2d 443 (1983); American Petroleum Institute v. E.P.A., 540 F.2d 1023 (Cir. 10, 1976), c.d. 414 U.S. 1146 [E.P.A. regulations on pollutant discharge by oil refineries]. A conclusion without stated factual basis and articulation of explanation is simply not enough.

Second, why is the audit requirement and its exorbitant cost thrust upon BHCs with $150 million or more in consolidated assets? There is not a word in the Proposal, Supporting Statement or the final issued BHC Reporting Requirements as to

why the threshold shouldn't be $175 million or $200 million or $250 million, etc. Do BHCs with $150 million of consolidated assets violate the BHCA more than those with $175 million, or $200 million, or $250 million, etc.? No factual basis given - only a result. This is insufficient.

Third, why is it not possible to use the Federal Deposit Insurance Corporation's or the New Mexico Director of Financial Institution's examination reports? This goes completely unmentioned by the Board. If the Board believes that the regulators' bank examinations are faulty, the Board should say that permitting the regulations victims to have a fair chance to controvert it. The statute, 12 U.S.C. §1844(c) and the regulation, 12 C.F.R. §225.5(c), mandate that the bank regulators' examinations will be used "as far as possible". Why not use them as they are the same

numbers only rearranged for the Board's computer? If the Board wants to make a finding that the bank regulators' reports of examination are hogwash, then require that the Board say so. Petitioner does not think the Board has that much guts. Obviously, the Board has not met this Court's standard of review.

The opinion states that some banks are only examined every 18 months. Not so in New Mexico where §58-1-46A, NMSA 1978, requires that the New Mexico Director of Financial Institutions "shall examine the condition of each state bank at least once in each calendar year". Petitioner's bank is going to be examined annually. This 18 month statement from the Board's brief is not a finding properly to be considered by this Court.

Finally, the Board states no reason, other than a hallucinatory belief, that audits certified by independent public accountants are great. They aren't and Petitioner's Appendix of Its Exhibits Attached to Petitioner's Comment Before Board of Governors of the Federal Reserve System fairly proves this. Petitioner had a sequel to that evidence which it would like to attach to the record. The truth is that every medium and large size bank that went into receivership had a certified audit. Audits help little if any at all. This ridiculously expensive requirement is just evidence of the Board exercising its non-existent "public benefit" or "public interest" imagined power. The Board is not the guru of banks because owned in whole or in part by a holding company. It is far more wise to follow the holding of this Court in Dimension Financial, supra,

than to stray off into the unchartered waters of the Board's speculations.

CONCLUSION

It probably never occurred to the panel in the Tenth Circuit the certain result of calling a "report" an "audit certified by an independent public accountant". Every one, including courts, reading a statute calling for a "report" will now call for an audit certified by an independent public accountant. Such a result boggles the mind. Neither the judges or administrators will understand the difference.

The holding of the Tenth Circuit literally shrieks for a grant of certiorari. However much have been the good intentions of that court, it is wrong on every issue of law and misapplied what few facts it managed to understand correctly. Petitioner suggests that under these

circumstances this Court is compelled to grant the Petition for Writ of Certiorari.

Respectfully submitted,

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UNITED STATES COURT OF APPEALS

TENTH CIRCUIT

F I L E D
United States Court of Appeals
Tenth Circuit
AUG 30 1988
ROBERT L. HOECKER
Clerk

CBC, INC., a corporation,	)	
	)	
Petitioner,	)	
	)	
v.	)	No. 86-1001
	)	
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,	)	
	)	
Respondent.	)	

ON PETITION FOR REVIEW OF A REGULATION
OF THE BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM
(Federal Reserve System No. R-0548)

Lynell G. Skarda, of Clovis, New Mexico, for the Petitioner-Appellant.

Robert D. McGillicuddy (Richard K. Willard, Assistant Attorney General, Michael Bradfield, General Counsel, with him on the brief), Attorney, Board of Governors of the Federal Reserve System, for the Respondent-Appellee.

Before McKAY, BARRETT, and TACHA, Circuit Judges.

TACHA, Circuit Judge.

Petitioner CBC, Inc. (CBC) challenges the authority of the Board of Governors of the Federal Reserve Board (Board) to require that certain bank holding companies submit consolidated financial statements that are certified by an independent auditor. CBC also contends that there is no rational basis for the Board's establishment of a 150 million dollar threshold for the consolidated reporting requirement. We affirm.

I.

CBC is a one-bank holding company with assets exceeding 150 million dollars. It owns all of the stock of The Citizens Bank of Clovis (Bank). The bank is a New Mexico state bank and is examined by both the Federal Deposit Insurance Corporation and the Director of Financial Institutions of the State of New Mexico. CBC's challenge to the Board's regulatory action is two-pronged. First, it argues

that the Board lacks authority to require any bank holding company to submit the independently certified financial statements. Second, CBC contends that the reporting requirement is invalid because it requires audits of the bank holding companies' subsidiary banks, over which the Board has no authority.

The Bank Holding Company Act, 12 U.S.C. §1841 et. seq., "vests broad regulatory authority in the Board over bank holding companies 'to restrain the undue concentration of commercial banking resources and to prevent possible abuses related to the control of commercial credit.'" Board of Governors v. Dimension Fin. Corp., 160 S. Ct. 681, 684 (1986), (quoting S. Rep. No. 91-1084, 91st Cong. 2d Sess., reprinted in 1970 U.S. Code Cong. & Admin. News 5519, 5541). The Board has authority under the statute "to issue such regulations and orders as may

be necessary to enable it to administer and carry out the purposes" of the Act. 12 U.S.C. §1844(b). The Board may also "require reports under oath to keep it informed" regarding compliance with the Act and the Board's duly promulgated regulations. 12 U.S.C. §1844(c). Board regulations promulgated pursuant to the Act state that holding companies "shall furnish, in the manner and form prescribed by the Board," annual operation reports and any other information and reports the Board requires. 12 C.F.R. §225.5(b).

In 1985, the Board revised several of its reporting requirements. The revision challenged here changed the information to be reported in Agency form number FR Y-6. This form, which was adopted on December 15, 1985 after appropriate notice and comment, required that bank holding companies with consolidated assets of 150 million dollars or more submit

consolidated financial reports certified by an independent public accountant. Bank Holding Company Reporting Requirement, 50 Fed. Reg. 50,951 (1985). CBC contends that the Board has no authority under the Act to require such reports from bank holding companies. We disagree.

The Act gives the Board authority to "require reports under oath to keep it informed" as to whether the Act and regulations have been complied with. 12 U.S.C. §1844(c). The Act does not define "reports," nor does the statute limit the types of reports the Board could require. Thus, we must decide whether consolidated financial statements certified by an independent public accountant fall within the scope of "reports" authorized by the Act.

The Board is the agency charged by Congress with administering the Act. 12 U.S.C. §1844(b). When the Board

interprets the Act through its rulemaking authority we must give substantial deference to the Board's interpretation if it "provides a reasonable construction of the statutory language and is consistent with legislative intent." Securities Industry Ass'n v. Board of Governors, 468 U.S. 207, 217 (1984).

We hold that the Board's independent certification requirement derives from a reasonable construction of the statutory language. "A fundamental canon of statutory construction is that, unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning." Perrin v. United States, 444 U.S. 37, 42 (1979); Colorado High School Activities Ass'n v. NFL, 711 F.2d 943 (10th Cir. 1981). A "report" is defined as "something that gives information" or a "formal account of the results of an investigation by a person or group

authorized or delegated to make the investigation (an audit)." Webster's Third New International Unabridged Dictionary at 1925 (1981). Thus, if the word "report" is given its common meaning, the Board's new reporting requirement seems clearly to fall within the statutory authority. Independently certified financial statements provide the Board with information that is qualitatively different from that provided in uncertified financial statements, in a reporting format that may differ from those required by other regulatory agencies. The certification provides the Board with an increased measure of reliability regarding the financial statements. The bank objects to the certification requirement because it requires an audit. The auditing process makes possible the report and certification by the accountant. The resulting documentation is a

report. We decline to characterize the requirement of submitting financial statements certified by an independent accountant as anything other than the kind of informative and reliable report envisioned by Congress and authorized by the Act. We will not substitute our judgment with respect to the kinds of reports the Board requires where the choice of the Board is clearly reasonable in light of the language of the Act and the intent of Congress in passing the Act.

Having concluded that the Board's reporting requirement falls within the ambit of the statute's plain meaning, we will uphold it unless there is "a clearly expressed legislative intent to the contrary." Consumer Product Safety Commission v. GTE Sylvania, Inc., 447 U.S. 102, 108 (1980); Colorado High School Activities Ass'n, 711 F.2d at 945. In this case we find not only that there is

a lack of clear legislative intent to contravene the plain meaning of the word "reports," but that the purposes enunciated in the Act's legislative history support the Board's interpretation of that term.

One of the purposes enunciated in the Act's legislative history and evident throughout the Act, is "to prevent possible abuses related to the control of commercial credit." S. Rep. No. 91-1084, 91st Cong. 2d Sess., reprinted in 1970 U.S. Code and Admin. News 5519, 5541. The broad authority that section 1844(c) grants the Board to require reports is a necessary predicate to enhance the Board's ability to carry out this purpose. The Board is better able to detect abuses related to the control of commercial credit if it can require informative and reliable reports. The word "reports" as used in this Act must be broad enough to

encompass reliable documentary evidence of the commercial credit practices and the financial positions of bank holding companies and their subsidiaries. Unless the language is so construed, the Board will be hampered in its attempt to carry out one of its principal responsibilities under the Act.

We cannot say that the Board's interpretation is unreasonable. In its justification of the FR Y-6 reporting requirements the Board states:

> The FR Y-6 is the primary source for much of the financial and structural data on individual bank holding companies, their banking and nonbank subsidiaries and other regulated investments. The information enables the Federal Reserve to (1) monitor holding company operations and to insure that the operations are conducted in a safe and sound manner that

> protects the depositors of the subsidiary banks; and (2) determine holding company compliance with the prohibitions of the Bank Holding Company Act and Regulation.

50 Fed. Reg. 28,026, 28,027 (1985). This justification is consistent with the purposes for which Congress empowered the Board to require reports in meeting its responsibilities under the Act. We uphold the Board's decision to require certain bank holding companies to submit consolidated and independently verified financial statements.

In order to satisfy the Board's new reporting requirement, the subsidiary banks owned by affected bank holding companies will have to be audited. CBC argues that the Board has no such authority over the bank subsidiaries. Apparently, CBC contends that because other agencies have regulatory authority over the banking subsidiaries, the Board

lacks jurisdiction to require independent audits.

The Act refutes this argument on its face. Section 1844(c) allows the Board to "require reports under oath to keep it informed." This reporting authorization is limited only by the purposes of the Act. Section 1841(a) gives the Board jurisdiction over "any company which has control over any bank." In order to give effect to the purposes of the Act, the Board must be permitted to require reports from the banks owned by bank holding companies.

In requiring such reports the statute provides that "[t]he Board shall, as far as possible, use the reports of examinations made by the Comptroller of the Currency, the Federal Deposit Insurance Corporation, or the appropriate State bank supervisory authority." 12 U.S.C. §1844(c)

(emphasis added). CBC argues that this section requires the Board to use such reports to the exclusion of Board-instituted reporting mechanisms.

This language cannot be read so narrowly. The phrase "as far as possible" must be read in conjunction with the broad authority to require reports conferred on the Board in the same section of the statute. In our view, this section requires the Board to use other agencies' reports to the extent that those reports provide the same information, with similar assurances of reliability, and in the same timely manner as a certified financial report from an independent accountant. CBC argues that reports based upon FDIC examinations provide the same reliable and timely information as the independent auditor's certified report. Even if we were to assume that the examination method of FDIC examiners

and independent accountants produce reports of comparable reliability, the record shows that complete FDIC examinations are not done on an annual basis at some institutions. The FDIC Manual of Examination Policies permits highly rated institutions such as CBC to go without a complete examination for up to thirty-six months. Audits by independent accountants, on the other hand, are consistently performed on an annual basis in order to produce the annual certified report the Board requires on form FR Y-6.

CBC contends that the timeliness problem with reports based on these FDIC examinations can be solved by updating them. However, the methods used to update such reports, including visitations by FDIC examiners and off-site reviews of financial information, can be far less complete than a full FDIC examination. It would not be

unreasonable for the Board to conclude that the qualitative differences between a certified financial report based upon a complete annual audit and a FDIC report updated by procedures which are less thorough than a complete examination, make it impossible to obtain the same reliable information from the FDIC reports.

CBC has failed to show that it is possible to get the same reliable, timely financial information from FDIC reports, and it has failed to produce evidence of reports of other agencies which would meet these requirements. Therefore, we cannot conclude that the Board's requirement of certified financial statements from an independent accountant contravenes the statutory requirement to utilize regulatory agencies' reports where possible. The Board has acted within its authority granted by Congress,

and without proof to the contrary, we will not substitute our judgment regarding the kind of information required by the Board to fulfill its statutory responsibilities.

II.

CBC also challenges the threshold established by the Board for the applicability of the reporting requirement. Before the 1985 revision, bank holding companies with banking assets exceeding 100 million dollars had to submit consolidated financial statements. Under the revised regulations, those reporting requirements apply to bank holding companies with consolidated assets exceeding 150 million dollars. CBC argues that there is no rational basis for either threshold.

The Act gives the Board discretion in implementing its reporting requirements. Section 1844(c) states that the

"Board may require reports under oath." (Emphasis added.) This discretionary language implicitly authorizes the Board to make reasoned judgments about the kinds of reports it will require and about the bank holding companies from which it will require them. If there is a rational basis for the Board's determinations, see Wyoming Hospital Ass'n v. Harris, 727 F.2d 936 (10th Cir. 1984), we cannot say that the Board has acted arbitrarily and capriciously.

The Board is uniquely qualified to determine the point when the size of a bank holding company requires the imposition of more stringent reporting requirements in order to administer the statute effectively.

We hold that the Board acted within its statutory authority in requiring from bank holding companies consolidated financial statements that are independently

certified, and in establishing a 150 million dollar threshold for the reporting requirement to attach.

AFFIRMED.

Supreme Court, U.S.
FILED
MAR 6 1989
JOSEPH F. SPANIOL, JR.
CLERK

No. 88-1109

In the Supreme Court of the United States

OCTOBER TERM, 1988

CBC, INC., PETITIONER

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

WILLIAM C. BRYSON
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Washington, D.C. 20530
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MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

Petitioner challenges a determination by respondent Board of Governors of the Federal Reserve System that the Board has authority under the Bank Holding Company Act (BHCA or Act), 12 U.S.C. 1841-1848, to require bank holding companies having more than $150 million in consolidated assets to submit financial statements that are certified by an independent public accountant as a part of the companies' annual report to the Board.

1. The BHCA comprehensively regulates bank holding companies. Section 5(c) of the Act, 12 U.S.C. 1844(c), provides that the Board "may require reports under oath to keep it informed as to whether the provisions of [the Act] and such regulations and orders issued thereunder have been complied with." Pursuant to that provision, the Board has long required bank holding companies to sub-

mit annual reports of operations in a prescribed form (Form FR Y-6). 12 C.F.R. 225.5(b).

On July 9, 1985, the Board issued a proposed regulation revising the reporting requirements for Form FR Y-6 and other forms. 50 Fed. Reg. 28,026. The Board proposed to modify the existing requirement that bank holding companies having at least $100 million in consolidated banking assets must submit financial statements certified by an independent public accountant. Under the proposed revision, bank holding companies with total consolidated assets (nonbanking as well as banking) exceeding $150 million were to be required to submit certified financial statements. *Id.* at 28,030. The Board stated that the proposed change would reduce the reporting burden for some bank holding companies. *Ibid.*

2. Petitioner, a bank holding company with total consolidated assets in excess of $150 million, submitted a comment on the proposal objecting to the certified financial statement requirement. R. 29-245. Petitioner argued that the Board lacks statutory authority to require certified financial statements. Petitioner suggested that the Board is required instead to rely on reports of examinations of subsidiary banks made by other federal and state bank regulators. R. 30-48.

On December 13, 1985, the Board adopted the proposed revision to Form FR Y-6 requiring bank holding companies with total consolidated assets in excess of $150 million to submit auditor-certified financial statements. 50 Fed. Reg. 50,950, 50,951. As statutory authority, the Board relied on Section 5(c) of the BHCA. *Id.* at 50,956. The Board explained that the certification requirement promotes safe and sound operations. *Ibid.*

3. On a petition for review filed by petitioner under 12 U.S.C. 1848, the court of appeals upheld the Board's modified regulation. Pet. App. A1-A19. The court con-

cluded that the Board's requirement of certification by an independent accountant is based on a reasonable construction of BHCA Section 5(c), which authorizes the Board to require reports from bank holding companies. Pet. App. A6-A17. The court found that financial statements certified by an independent accountant fall within the ordinary meaning of the statutory term "reports" (*id.* at A6-A9) and that the auditor-certification requirement is consistent with the purposes of the Act because it enables the Board to meet its statutory responsibility to obtain reliable evidence of the commercial credit practices and financial positions of bank holding companies and their subsidiaries (*id.* at A9-A12).

The court of appeals also concluded that the Board must be permitted to require reports of a bank holding company's subsidiary banks, as well as of the holding company itself, in order to give effect to the purposes of the Act. Pet. App. A12-A13. Further, the court found that the Board was not required to use examination reports prepared by other bank supervisory authorities in lieu of certified financial statements, explaining that the Board is required to use such examination reports only "as far as possible" (12 U.S.C. 1844(c)) and that petitioner had failed to show that such reports produce the same reliable, complete, timely information as the more frequent reports required by the Board. Pet. App. A13-A17. Finally, the court concluded that the Board's selection of $150 million in consolidated assets as the minimum threshold for the certified financial statement requirement is within the Board's discretion under the statute and is arbitrary and capricious. *Id.* at A17-A19.

4. The Board's determination that BHCA Section 5(c) authorizes it to require financial statements in annual reports certified by independent public accountants was correctly upheld as a permissible construction of the statute by the agency charged with administering it. See

Chevron U.S.A. Inc. v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843 (1984); see also *Northeast Bancorp, Inc.* v. *Board of Governors*, 472 U.S. 159, 168 (1985) (Board is "an authoritative voice on the meaning of a federal banking statute"); *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. 234, 251 (1978).[1] Section 5(c), 12 U.S.C. 1844(c), provides that "[t]he Board from time to time may require reports under oath to keep it informed as to whether the provisions of [the Act] and such regulations and orders issued thereunder have been complied with." The provision gives the Board substantial discretion to determine the form and content of required reports, and the language is plainly broad enough to encompass a requirement of certified financial statements—like those in an "auditor's report"—as long as the requirement reasonably advances the Board's ability to carry out its responsibilities under the BHCA.

The requirement of auditor-certified financial statements at issue in this case advances the Board's ability to carry out its statutory duties to monitor the financial condition of bank holding companies to ensure their safe and sound operation. For example, the Board must consider

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[1] In 1957, the year after enactment of the BHCA, the Board began requiring relatively large bank holding companies to submit annual reports with financial statements certified by independent accountants. 22 Fed. Reg. 2341 (1957). Since then, although specific reporting requirements for the annual report have been modified from time to time, the direction that financial statements submitted with annual reports be certified by independent accountants has, with one brief exception, been continuously retained for covered bank holding companies. *E.g.*, 31 Fed. Reg. 14,800 (1966); 32 Fed. Reg. 3813 (1967). In 1975, the Board allowed all bank holding companies to submit annual reports with unaudited financial statements, but the following year the Board reinstated the requirement of certified statements for bank holding companies with consolidated banking assets of more than $100 million. R. 89-90.

the financial condition of a bank holding company when the company acquires a bank or nonbank company. 12 U.S.C. 1842(c), 1843(c)(8); *Board of Governors* v. *First Lincolnwood Corp.*, 439 U.S. at 243, 249-251; 12 C.F.R. 225.24. In addition, the Board may terminate any direct or indirect nonbanking activity of a holding company if, among other things, the activity poses "a serious risk to the financial safety, soundness, or stability of a bank holding company subsidiary bank." 12 U.S.C. 1844(e). Also, Section 5(c) specifically authorizes the Board to "make examinations of each bank holding company *and each subsidiary thereof.*" 12 U.S.C. 1844(c) (emphasis added). See also S. Rep. No. 1084, 91st Cong., 2d Sess. 24 (1970) (BHCA purpose "to prevent possible abuses related to the control of commercial credit"); Pet. App. A10-A11. In short, the particular reporting requirement at issue here is reasonably related to the Act's purposes and the Board's functions under the Act.[2]

The requirement of financial statements certified by independent accountants is entirely consistent with Section 5(c)'s direction that the Board "shall, as far as possible, use the reports of examinations made by the Comptroller of the Currency [the primary supervisor of national banks],

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[2] Contrary to petitioner's assertion (Pet. 12-20), the decision of the court of appeals upholding the Board's regulation does not conflict with this Court's holding or reasoning in *Board of Governors* v. *Dimension Financial Corp.*, 474 U.S. 361 (1986). *Dimension* involved administrative interpretations of the terms "demand deposit" and "commercial loans" in the BHCA's definition of "bank." 474 U.S. at 364-365. In contrast to the Board's construction of the authority to require "reports" in Section 5(c) of the Act, this Court found in *Dimension* that the Board's interpretation of the "bank" definition was inconsistent with the unambiguous meaning of the statutory language. 474 U.S. at 373-374. Here, the construction adopted by the Board is fully consistent with the common understanding of the "plain language" of Section 5(c) of the BHCA.

the Federal Deposit Insurance Corporation, and the appropriate State bank supervisory authority." 12 U.S.C. 1844(c). That direction by its terms provides only that examination reports of bank supervisors shall be used "as far as possible." Moreover, Section 5(c) expressly contemplates that the Board itself "may make examinations of each bank holding company and each subsidiary thereof." Here, as the court of appeals concluded (Pet. App. A14-A17), there is a reasonable basis for the Board to conclude that the supervisory agencies' examination reports relating to subsidiary banks of holding companies do not fully substitute for a certification by an outside auditor of financial statements contained in the holding companies' annual reports. Even aside from the fact that bank examinations may not as heavily focus on the propriety of the company's accounting methods and the adequacy of the company's mechanisms to detect and deter fraud, complete bank examinations in many cases are performed only at irregular intervals of up to three years. *Id.* at A15. And updates of such examinations may provide less complete information than can the annual audits required by the Board. *Id.* at A15-A16.

Finally, the Board acted reasonably in applying the requirement of a certified financial statement to all bank holding companies with more than $150 million in consolidated assets. Selection of such a threshold involves weighing the costs of compliance for smaller institutions against the supervisory benefits to be achieved by the certification requirement; and any particular threshold dollar figure is necessarily arbitrary in the sense that a slightly higher or lower figure is not materially distinguishable. An agency must have wide discretion in selecting such a threshold. Here, the Board's selection of $150 million in total assets as a threshold was reasonable, as the same threshold has

been used to identify smaller bank holding companies for various other regulatory purposes.[3]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

WILLIAM C. BRYSON
Acting Solicitor General

MARCH 1989

[3] For example, under the Board's guidelines for determining the capital adequacy of banking institutions, bank holding companies with less than $150 million in consolidated assets are generally allowed to determine compliance based on the capital of the subsidiary bank alone. *E.g.*, 71 Fed. Res. Bull. 445, 446 n.1 (1985); 54 Fed. Reg. 4186, 4209 (Jan. 27, 1989). The Board has also used a benchmark of $150 million in consolidated assets to identify certain types of shell bank holding companies that are small enough that supervisory examinations may be performed less frequently than for larger companies. Fed. Res. Regulatory Serv. para. 3-1531 (1985).

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